

A Global Realignment by 2020: U.S. Decline, Emerging Economies Rise

by Francis Cripps, Director of Alphametrics, and Terry McKinley, Director of CDPR, SOAS

In CDPR's Development Viewpoint #2, we projected until 2015 the impact on the global economy of rising oil prices, a falling dollar and a U.S. recession, and then the additional effect of the monetary and fiscal stimulus that the U.S. Government implemented in response to the crisis. In the process, we discovered that the long-term prospects of the U.S. economy were projected to worsen after 2015.

So, for our current modelling, we: 1) project outcomes for 2020 instead of 2015 and 2) assume a sizeable yearly U.S. fiscal stimulus for 2008-2011 instead of just 2008. The total stimulus package—which amounts to 0.5 per cent of GDP each year in tax cuts, additional expenditures and credit incentives for private investment—should help the U.S. economy not only escape a severe recession but also fare better over the long term than originally projected.

Our focus in this Development Viewpoint is the resultant impact of such a scenario on the U.S. economy itself and on three large emerging economies, Brazil, China and India. Note that we hold constant, for now, the policy stance of these three countries.

We find that U.S. income per capita would begin falling after 2013, as the impact of our assumed four-year fiscal stimulus wore off. During the whole period 2008-2020, the projected growth of U.S. income per capita is only 0.5 per cent per annum, well below that of most other developed economies. If our assumed stimulus had not been applied, the projected outcome would have been much worse.

Why the U.S. Decline?

The principal determinants of U.S. decline are deep-seated structural problems, such as the persistence of a large current account deficit and an onerous external indebtedness. Despite the slowdown in U.S. growth, its current account deficit is projected to rise from -5.5 per cent of GDP in 2008 to -6.3 per cent in 2020.

We make the critical assumption that dollar devaluation—which could play a supplementary role to fiscal policy—would cease in 2010. This would be necessary, we conclude, to contain mounting inflationary pressures (due to persistently high fuel and food prices) as well as mounting debt problems.

In contrast to U.S. stagnation and decline, China's income per capita is projected to grow by 4.7 per cent per annum during 2008-2020. This is a marked slowdown from its recent trend rate of growth of 7-8 per cent, but still high compared to the projected rates of other developing and developed countries.

Because of the global slowdown, especially U.S. stagnation, China's substantial current account surplus in 2008, namely, 6.8 per cent of GDP, would be cut by a full three percentage points by 2020. And it would face further challenges after 2020 from its increasing imports of manufactures, raw materials and high-cost energy.

India is projected to continue its current momentum of four per cent growth of per capita income through 2020 despite the global slowdown. Since it is less dependent than China on imports, its current account would noticeably

improve, progressing from a deficit of -2.4 per cent in 2008 to a small surplus of 0.5 per cent in 2020. This would be based on growing service income and increasing exports of manufactures.

Brazil's per capita income is slated to grow by a somewhat slower, but still credible, 3.4 per cent. It would benefit from sustained demand for its commodity exports and increased intra-regional trade and investment. But its conservative financial policies, which prop up the value of its currency, imply that its small current account deficit (i.e., a negative 0.3-0.4 per cent of GDP) would change little by 2020.

Global Realignment

Given the growth trends of all developed and developing countries, we project that by 2020 there would be a major realignment of the global economy, with the United States sinking significantly in importance and the three emerging economies assuming greater prominence.

In 2008, the size of China's economy (measured in purchasing power parity terms) was about 86 per cent of the U.S. economy's. By 2020, the corresponding percentage would be about 132 per cent (see Figure). Thus, China's economy would be the largest in the world, its size surpassing handily both those of the U.S. and Western Europe.

India's economy would enlarge from about 35 per cent of the U.S. economy in 2008 to about 55 per cent in 2020, and surpass the size of Japan's economy by about 45 per cent. From a much smaller starting point, Brazil would also acquire significantly more economic weight. For example, its economy would be about 38 per cent larger than Eastern Europe's total economy and be approaching one fifth of the U.S. economy.

These results suggest that there would likely be seismic economic and political changes by 2020. These dynamics would be even more dramatic if the economic policies of China, India and Brazil were adjusted in order to enhance their long-term development prospects. This a topic to address in future papers.

